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DRAFT REPORT OF THE AD HOC WORKING GROUP ON INVESTMENT AND FINANCIAL FLOWS; NON-DEBT-CREATING FINANCE FOR DEVELOPMENT; NEW MECHANISMS FOR INCREASING INVESTMENT AND FINANCIAL FLOWS ON ITS SECOND SESSION

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Rapporteur: Mr. E. Mercado (Mexico)

Addendum

CONTENTS

Chapter		Paragraphs
II.	Consideration of host and home country policies to promote foreign direct investment (agenda item 2)	33 - 48
III.	Multilateral measures to promote foreign direct investment (agenda item 3)	49 - 52

Chapter II

CONSIDERATION OF HOST AND HOME COUNTRY POLICIES TO PROMOTE FOREIGN DIRECT INVESTMENT

(Agenda item 2)

33. For its consideration of this item, the Ad Hoc Working Group had before it the following documentation:

"Host country policies and measures to promote foreign direct investment: a synthesis of eight case studies - report by the UNCTAD secretariat" (TD/B/WG.1/10);

"Case study submitted by Myanmar" (TD/B/WG.1/Misc.3/Add.10).

34. The Working Group examined the secretariat report (TD/B/WG.1/10) providing a synthesis of the policies and measures to promote foreign direct investment described in the case studies submitted to the Working Group by eight host countries (Brazil, China, India, Mexico, Morocco, Nigeria, Philippines and Republic of Korea).

Conclusions from the case studies

35. The Working Group noted that the trend towards liberalization and market-oriented reforms had characterized economic policies in the countries concerned since the 1980s, the overriding theme being efficiency through competition. While most of the policy measures had been undertaken with broader macro-economic objectives in view, clearly these were positive elements which would be attractive to foreign investors. It was, however, hard to measure the precise and full extent to which these policies had influenced FDI flows to individual countries. Some of the reforms were too recent or were of a structural nature and would take time to be fully implemented, and it was, therefore, too early to assess their full impact on FDI.

36. The case studies revealed a high degree of policy convergence in terms of objectives but showed variations in approach, in timing and scope of reform, and in the effectiveness of specific measures in achieving desired results.

37. In the eight countries examined, the broad objective of macroeconomic policies had been the achievement of sustained growth and stability, which were

essential elements of an enabling investment climate. Fiscal reform had been aimed at keeping a lid on the budget deficit mainly through a more rational use of public funds on one hand and by broadening the tax base while at the same time reducing tax rates on the other hand. The main thrust of monetary policy had been to curb excess liquidity in order to attain price stability, while maintaining flexibility to stimulate growth. A gradual process leading to full currency convertibility had characterized exchange rate policies. There had also been a reduction in foreign exchange controls and a less interventionist approach to wage and price determination.

38. Market-oriented reforms had affected a wide range of economic activities. The principal trade liberalization measures had involved significant reduction of tariff rates, simplification and rationalization of the tariff structure and a reduction or abolition of import-licensing requirements and quantitative restrictions. Industrial policy reform had been geared towards enhancing industry's contribution to development by emphasizing efficiency and competitiveness and a more outward orientation. The prominence given to the private sector was reflected in some countries in massive privatization programmes which had served as catalysts for FDI growth. A gradual opening of the financial sector to foreigners had been taking place. Measures to liberalize interest rates and create confidence in the financial system through strengthened regulatory frameworks and higher capitalization ratios had also been adopted.

39. In recognition of the importance of developing technological capabilities not only to promote FDI but, above all, for the efficient functioning and modernization of the domestic economy, Governments had given priority to investment in infrastructure and human resource development. The growing awareness of the need for sustainable development had led to the establishment of regulatory frameworks for environmental protection.

40. The 1980s had witnessed a marked change in the attitude of developing countries towards foreign direct investment, which was reflected in the widespread trend towards liberalization of FDI regimes. Variations existed, however, in the pace, timing and degree of liberalization. Specific measures to facilitate the entry of foreign investors included the shift to negative lists and simplification of administrative procedures. However, significant entry restrictions remained, especially in so-called sensitive areas such as natural resource exploitation, transport and communications, banking and financial services.

41. Governments had shown great willingness to act in areas where investors' frustrations were more pronounced, such as those concerning the free transfer of profits and dividends, repatriation of capital, dispute settlement, protection of property rights, including intellectual property rights, and the removal or reduction of performance requirements. The principle of equal treatment was now generally accepted.

42. Fiscal, financial and other incentives remained an important part of investment promotion packages. While their effects on stimulating new investments were hard to measure, they nevertheless represented substantial costs for the host countries. Much had been done to improve investment promotion activities, stressing information and advisory services, the establishment of one-stop shops for investment services, marketing and the use of joint investment forums. Debt-equity swaps in conjunction with privatization programmes had had salutary effects on new investment flows. Several countries had also established export processing zones as a means of attracting FDI in export-oriented industries.

43. In recent years, the number of bilateral investment protection agreements and tax treaties had increased significantly. Membership in multilateral and regional investment arrangements were also increasingly seen as providing a stable and attractive framework and better risk coverage.

44. The Working Group concluded that the macro-economic policy framework and policies and measures specific to FDI constituted only some of the elements, albeit vital ones, in investment location decisions. The existence of economic potential, political stability and other factors that affected the risk and profitability of investment were equally important.

Other discussions

45. A number of countries that had submitted case studies indicated changes in FDI regulations and other measures affecting FDI since the submission of their reports, and they updated some figures. Most of these changes showed that the process of liberalization was continuing.

46. The Working Group noted that most case studies had not identified areas where financial and technical assistance from bilateral and multilateral

institutions would be needed. In addition, there had been no assessment of the effectiveness of home country incentives and promotional measures.

47. A number of delegates stated that the topic of discrimination deserved further consideration. Some measures in favour of foreign investors, which could be discriminatory to local firms, were sometimes provided to compensate foreign investors for the inherent disadvantages of working in a foreign environment. Moreover, competition to attract FDI had led to the granting of numerous incentives, notably tax incentives, which were not available to local companies. The views expressed by participants from the private sector during the second session of the Working Group indicated that incentives did not rate highly in the investment decision process. Another form of discrimination was the imbalance affecting local partners in joint ventures, especially SMEs, which experienced difficulty in obtaining access to international financing.

48. The delegations of Algeria, Bulgaria, Romania and Turkey gave an overview of FDI policies in their countries. A common feature of these policies was a liberal framework or a relaxation of restrictions. The willingness to negotiate bilateral investment agreements was also evident. Some of these countries were already members of MIGA.

Chapter III

MULTILATERAL MEASURES TO PROMOTE FOREIGN DIRECT INVESTMENT

(Agenda item 3)

49. For its consideration of this item, the Ad Hoc Working Group had before it the following documentation:

"The role of international financial institutions in promoting non-debt-creating flows to developing countries" - report prepared by the World Bank (TD/B/WG.1/Misc.2/Add.8);

"UNIDO initiatives to promote non-debt-creating financial flows to developing countries, with particular reference to foreign direct investment" - report prepared by UNIDO (TD/B/WG.1/Misc.2/Add.9).

50. The Working Group heard statements from the representatives of UNIDO, the World Bank and UNCTAD's Programme on Transnational Corporations. The Working Group noted that all three organizations engaged in the provision of technical assistance and advisory services with regard to the promotion of non-debt-creating financial flows and FDI in particular.

51. The discussion focused on the complementarity and potential overlap of the activities of the organizations concerned. Information was supplied about cooperation between organizations and efforts to avoid overlap.

52. A number of countries described their experience with technical assistance received from these institutions, which had been found to be very valuable.